

BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

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FEB 14 1997

In the Matter of)	
)	
Access Charge Reform)	CC Docket No. 96-262
)	
Price Cap Performance Review for)	CC Docket No. 94-1
Local Exchange Carriers)	
)	
Transport Rate Structure and)	CC Docket No. 91-213
Pricing)	

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

REPLY COMMENTS OF WORLDCOM, INC.

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SUMMARY

- **WorldCom's Access Reform Plan – A Third Way.**

- An immediate prescription of all access rates to cost is unnecessary if the FCC takes all necessary steps to ensure that local competition has a reasonable chance to grow in the near future.
- On the other hand, a market-based approach will not work if ILECs are allowed excessive pricing flexibility that could facilitate discrimination, or if their revenues are guaranteed free of competitive pressure.
- Instead, WorldCom supports a market-based approach that would rely primarily on local competition to drive originating access rates toward cost, and would use access reform to promote local competition:
 - > Reform access rate structure and certain rate levels: Expose most ILEC access services to competitive pressure, while reducing rates for services (e.g., terminating usage) that will never be competitive.
 - > Use “carrots” and “sticks”: Offer ILECs non-discriminatory forms of pricing flexibility to induce them to fully implement local competition; reserve threat of rate prescriptions if they do not.

- **The ILECs' Over-Reaching Arguments for Both Revenue Guarantees and Deregulation are Mutually Inconsistent, and Must Be Rejected.**

- Revenue guarantees, such as “bulk billing” or depreciation recovery mechanisms, are inconsistent with a competitive marketplace. Further, there is absolutely no legal or policy warrant for such guarantees.
- Premature deregulation or streamlining of ILEC access regulation would enable the ILECs to squelch local competition.
- An uneconomic access charge “tax” on unbundled network elements would thwart local competition, and would doom market-based access reform.
- No transport rate structure or pricing changes are necessary now. But if the FCC elects to revisit this issue, common and dedicated transport must be treated consistently, using an accurate understanding of the geodesic interoffice network. (See attached diagram.)
- The ILECs must not be allowed double recovery of the shared costs of their SS7 networks from vertical service offerings and carriers. Instead, adopt “bill-and-keep” for carrier-to-carrier SS7 network interconnection.
- Unlike the ILECs' proposals, WorldCom recommends pragmatic reforms to existing price cap baskets and service categories.

WORLDCOM'S PROPOSAL FOR GRADUAL IMPLEMENTATION OF ACCESS REFORM

Timing of Order	Issues to Address	Likely Results
Adopt in April/May 1997; ILEC tariffs effective 7/1/97	<u>Rate Structure</u> <ul style="list-style-type: none"> • Eliminate per minute CCL and recover all subscriber loop costs through flat rate charges • Establish flat rate for line-side local switch port • During transition, recover TIC as a flat rate charge <u>Rate Level</u> <ul style="list-style-type: none"> • Set initial level of switch port rate based on TELRIC times interstate allocation • Re-initialize terminating local switching based on TSLRIC • Remaining local switching revenues recovered through originating charges • Easiest rate level fixes to TIC (e.g., target universal service, price cap reductions) <u>Phase I Triggers and Pricing Flexibility</u> <ul style="list-style-type: none"> • (See WorldCom's initial comments) 	<ul style="list-style-type: none"> • Makes rate structure more cost-based • Imposes most of rate burden on elements for which competitive pressure is most likely to be felt • Avoids up-front prescriptive rate reductions, but also avoids revenue guarantees • Incumbent LECs retain revenues to the extent they retain end user customers
Adopt in Fall 1997; ILEC tariffs effective 1/1/98	<ul style="list-style-type: none"> • Complete 4th FNPRM in price caps • Complete plan to eliminate TIC 	<ul style="list-style-type: none"> • More analytically difficult measures to complete stage setting for local competition
Adopt in early 1998; implementation based on ILEC performance and competitive conditions	<ul style="list-style-type: none"> • Specify triggers and pricing flexibility for phases beyond Phase I • Specify prescriptive measures if ILECs do not meet Phase I checklist • Address ESP/ISP issues 	<ul style="list-style-type: none"> • Establish plan for lessening of regulation as local and full-service competition develops further • Establish fall-back in case local competition does not develop

The Incumbent LEC Inter-Office Transmission Network

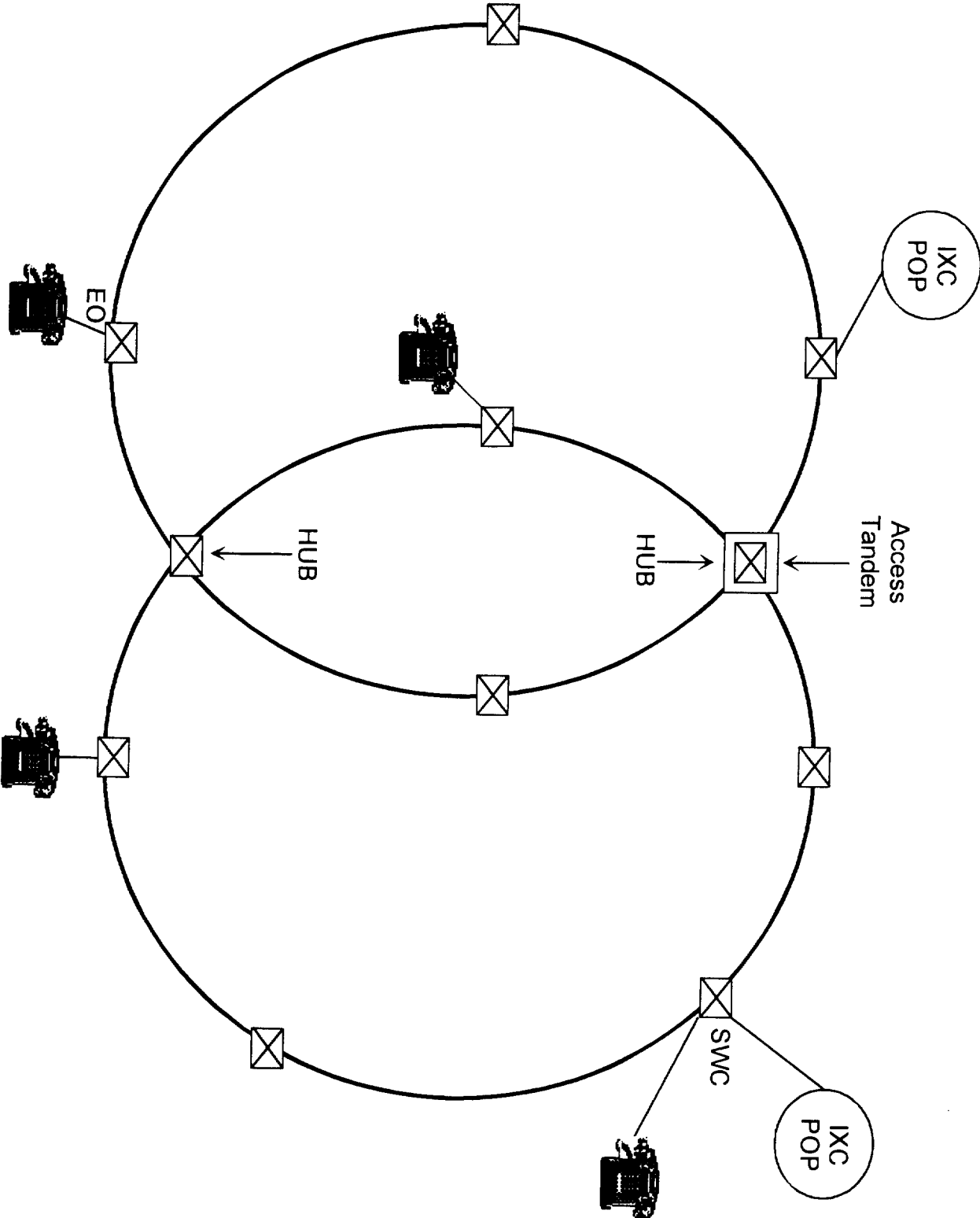


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REPLY COMMENTS OF WORLDCOM, INC.

WorldCom, Inc. ("WorldCom") hereby submits its reply to the initial comments of other parties on the Commission's Notice of Proposed Rulemaking, FCC 96-488 (released December 24, 1996) ("Notice") in this proceeding.

INTRODUCTION

The comments in this proceeding generally fall into one of three categories:

One camp consists of those parties that believe that local competition is at best several years away, and not certain even then. These parties make a strong showing that prescription is the only way to bring access rates to cost, and thereby foster both cost-based interexchange services and full service competition for the public.

The incumbent local exchange carriers (“incumbent LECs” or “ILECs”) make up a second, completely different camp. They put forth astonishing claims that local competition is already here, or on the near horizon. They ask for the sort of pricing flexibility now that AT&T received only several years after divestiture, when facilities-based interexchange competition was available to consumers everywhere. At the same time, the ILECs argue for access revenue guarantees that are the antithesis of competition.

WorldCom and certain other parties approach access reform from a third perspective. We refuse to put on the rose-colored glasses offered up by the ILECs. We know that local competition will take time to develop, and that the ILEC access bottleneck will remain unavoidable until then. But at the same time, we do not necessarily agree that broad rate prescriptions are needed now -- so much as rate restructuring that more directly subjects access to future competitive pressures. We are hopeful that the Commission will be able to implement the 1996 Act successfully. If so, we expect to use ILEC network elements to provide local service. We will order them where we already own local network facilities, and where we do not, to compete across the country.

As we discussed in our initial comments, the possibility, let alone existence, of local competition is inextricably related to a market-based access reform system. For example, originating access is not a competitive service per se; it is an input that an interexchange carrier (“IXC”) can avoid purchasing only by becoming the end user’s local service provider. Thus the rates consumers pay for

the total package of local and long distance service can fall as new providers capture local customers and provide their own access rather than paying for ILEC access. But that market process depends heavily upon full implementation of the 1996 Act, so that carriers like WorldCom can enter the local market using ILEC network elements without great difficulty.

WorldCom is sympathetic to those who have called for re-initialization of ILEC access rates at cost-based levels. We agree that this stricter approach would be necessary if the promise of the 1996 Act is broken through ILEC resistance or unexpected court action. As a result, we have recommended that the Commission hold the possibility of broad access rate prescription in reserve.

Meanwhile, however, we have suggested more modest up-front changes that we believe can create the fundamental conditions for the reduction of access costs -- and do so quickly. Another copy of the summary to our initial comments is provided here as Attachment A for the convenience of the Commission. That summary sets out the specific rate structure changes that we have proposed. Our recommendations reflect three core principles:

1. Restructure access rates now to more closely match the basis on which costs are incurred;
2. Focus immediate rate prescriptions on those elements that are the least susceptible to competition; and
3. Expose remaining access charges to competitive pressure as local competition gradually rolls out.

We believe that these principles will best serve the public interest by driving access rates toward cost, and thereby permitting lower long distance prices for all customers. And these principles are also consistent with the broad development of local competition itself.

As the Commission well knows, thousands of pages of comments have been filed in this crucial docket. WorldCom is not in a position to respond to all of the points made by other parties, and will not try to do so here. Instead, we begin by suggesting a schedule that would prioritize the steps that the Commission should take immediately, and defer less pressing issues to later orders. We emphasize that we are not advocating delay for delay's sake, and we have no objection to earlier resolution of as many issues as possible. We offer this schedule, however, out of an appreciation of the complexity of the immediate tasks before the Commission here, in the universal service docket, and elsewhere. To the extent that more time is required to complete all aspects of access reform, we suggest how the docket might be subdivided.

Second, we respond to major arguments of the ILECs that we find particularly inconsistent with the development of local competition (and thus access reform). For example, the Commission should reject out of hand ILEC assertions that they should continue to receive access revenue free from competitive pressures, for example, through bulk billed charges based on a competitor's revenues. Such "non-competitive" rate elements are a barrier to both lower long distance rates and new local competition. Similarly, the Commission should reject ILEC arguments

for premature pricing flexibility, especially flexibility to offer lower access rates only to selected access customers, without reducing them generally. Given that the access input makes up 40% of the cost of long distance service today, such discrimination could have devastating effects for both existing interexchange and nascent local competition.

Finally, WorldCom addresses selected access issues raised in ILEC comments, including ILEC arguments regarding tandem-switched transport and price caps. Again, it is not possible for us to respond to all of the comments in this docket that affect us. We rely on the Commission to see through illogical or self-serving positions and advance the public interest. We believe that the principles for access reform mentioned above can guide the Commission to sound decisions in all aspects of this critical proceeding.

I. THE COMMISSION SHOULD CONSIDER A STAGED APPROACH TO RESOLVING THE ISSUES IN THIS PROCEEDING.

WorldCom is well aware of the enormity of the task that the Commission faces in trying to resolve the numerous difficult issues arising from this proceeding. We suggest that, instead of trying to address all the issues at once in the very near term, the Commission could “bring home” this proceeding in at least three separate orders, staged over the next 12 months or so. Such an approach would work well with the overall access reform plan proposed by WorldCom. WorldCom’s proposal for staging access reform orders is presented graphically in a table in the Summary of these comments.

We strongly support the Commission's stated intent to adopt its first access reform order at about the same time as the statutorily required universal service order -- April to May, 1997. The changes adopted in this initial order could be implemented through ILEC tariff changes by July 1, 1997. This order must address the most egregious problems with the existing access rate structure, and should resolve the most pressing issues to facilitate the development of local competition. Correctly done, the Commission can improve the access rate structure measurably; harmonize access with changes required for universal service reform; and set the stage for local competition by enabling access customers to reduce their access costs over time as they become local service providers themselves. ILECs would not experience precipitous losses of revenue, but they would not receive any revenue guarantees either.

Specifically, this order should:

- (1) adopt the necessary rate structure changes to remove inefficiencies and to set the stage for local competition -- primarily, by eliminating the per minute CCL and TIC and establishing flat rate per-line charges for subscriber loops, line-side local switch ports, and the TIC;
- (2) make modest rate level prescriptions for a limited number of rate elements: terminating local switching (which is least likely to become subject to competitive pressure), tandem switching (in response to the CompTel v. FCC remand), and the TIC (at least the initial, analytically simplest steps, such as targeting all universal service and price cap reductions to the TIC); and
- (3) specify the pro-competitive steps that incumbent LECs need to demonstrate to qualify for Phase I ("potential competition") forms of pricing flexibility, and define the types of flexibility available at this stage.

The first access reform order need not make other changes to the transport rate structure or price levels (which, although far from perfect, represent a status quo that is a tolerable base level for the development of local competition). ^{1/} Also, the first order need not address the competitive triggers or the pricing flexibility measures for steps beyond Phase I, since it is extremely unlikely that any ILEC will be anywhere near meeting such triggers within the next year.

A second access reform order could be adopted in the fall of 1997, with a view toward ILEC implementation through tariff changes effective in January 1998. This order could conclude the Fourth Further NPRM in the price cap performance review proceeding to lower overall rate levels based on the pro-efficiency incentives created by the price cap system. It could also complete the more analytically difficult steps needed to eliminate the TIC, preferably with a transition period of no longer than one year. Finally, the second order could resolve any remaining rate structure issues, and address any necessary issues on reconsideration from the first order based on the emerging experience with interconnection and local competition (and probable resolution of any potential legal issues, such as the Eighth Circuit appeal of the Local Competition Order).

A third major access reform order could be adopted early in 1998. This order could address the competitive pre-conditions available at Phases beyond

^{1/} For a more complete discussion of the baseline access structure and rate level changes needed now, see WorldCom Comments at 27-72.

Phase I, and the forms of pricing flexibility available at those stages. (For example, WorldCom has suggested the use of multiple phases, such as Phases II-A and II-B for “emerging full-service competition” and “substantial full-service competition.”) At the same time, the Commission could specify the “stick” of prescriptive access rate reductions if the incumbent LECs do not at least meet the conditions for emerging local competition by a date certain (e.g., January 1999). Finally, the Commission could address the information service issues raised in the Notice of Inquiry, which should be somewhat simpler to resolve if local competition is succeeding in bringing access rates toward cost.

II. THE COMMISSION SHOULD RECOGNIZE THE INCUMBENT LECs’ ATTEMPT TO “HAVE THEIR CAKE AND EAT IT TOO” FOR WHAT IT IS

[Notice, Sections I, III.E, IV, V, and VII]

A. The ILECs’ Simultaneous Arguments for Deregulation and Revenue Guarantees are Mutually Contradictory

The Commission should not be taken in by the ILECs’ greedy attempt to “have it all.” The ILECs argue, on the one hand, that local telecommunications markets are so competitive today that the current regulatory system should be substantially streamlined, and that regulation should be virtually eliminated once the slightest indicia of developing competition can be demonstrated (e.g., when a state approves a single interconnection agreement). ^{2/} On the other hand, the

^{2/} See, e.g., USTA Comments at 27 and Attachment 8; Southwestern Bell Comments at iii, 26.

ILECs claim that the Constitution, and possibly also their good corporate citizenship, give them an absolute entitlement to an ironclad guarantee that they will forever continue to reap all the revenues that they are currently receiving, including dollars associated with the TIC, depreciation, and a laundry list of other claimed costs. 3/

But the ILECs' claims are inconsistent and self-contradictory. They want to be treated as if the local marketplace is fully competitive -- which we certainly hope it will be some day, but no part of it is today. But they also want to be assured revenue neutrality, like thoroughly regulated rate-of-return monopoly utilities, with the help of some surprisingly prescriptive regulatory proposals to assign revenues to certain relatively non-competitive rate elements. The ILECs can't have it both ways. In an increasingly competitive marketplace, no company can be guaranteed revenues. We realize that this is all new for the ILECs, but they need to get used to it: no regulatory agency can lawfully ensure them revenue recovery. They may or may not succeed in recovering all their investments in a competitive marketplace; they may win big, or consistently faulty business judgment could cause them to lose their shirts. The key to success will be providing high-quality services to end users at reasonable rates, and retaining and growing

3/ See, e.g., GTE Comments at 35-41; USTA Comments at 68-80; Bell Atlantic/NYNEX Comments at 27-31, 36-38.

the customer base in a competitive manner -- not abusing the regulatory process to try to obtain subsidies from competing carriers. 4/

At the same time, the ILECs seek an astounding degree of pricing flexibility, with barely any check to ensure that competitors have opportunities to enter local markets. The ILECs would have the Commission essentially deregulate special access and dedicated transport now, and eliminate rate structure regulation of other services, with no specific proof that competition for these services is possible. 5/ And they suggest that a single state-approved interconnection agreement or statement of generally available terms ("SGAT") should lead to substantial deregulation of most other access services. But no one can seriously suggest that the mere paper existence of a single approved agreement or SGAT is all it takes to make vibrant local competition a reality. The Commission's proposed thresholds for Phase I have it much more nearly right. The deregulation proposed by the ILECs would facilitate a tremendous degree of anti-competitive conduct by

4/ All of this assumes that the ILECs will not use their continuing bottleneck control over unbundled network elements to obtain subsidies in other ways. For purposes of projecting how local competition is likely to develop, WorldCom assumes full ILEC compliance with Sections 251 and 252 and the Local Competition Order. 47 U.S.C. §§ 251 & 252; Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, CC Docket No. 96-98, First Report and Order, 11 FCC Rcd 15499 (1996) ("Local Competition Order"), recon., 11 FCC Rcd 13042 (1996), second recon., FCC 96-476 (released Dec. 13, 1996), pet. for review pending sub nom. Iowa Utilities Board v. FCC, No. 96-3321 (8th Cir.).

5/ We address this argument in more detail below. See Section III.A.

these monopolists -- including discrimination in favor of their interexchange affiliates -- with no assurance that local competition is anywhere in sight.

The ILECs try to “have their cake and eat it too” in other ways as well. They seek elimination of “sharing” from the price cap system, elimination of the consumer productivity dividend, and reduction or elimination of the “X” factor (the rate adjustment for increased productivity that forms the critical basis of the productivity incentives in the price cap system). 6/ These changes would eliminate the existing provisions that ensure that ILECs share with ratepayers a limited amount of the benefits of productivity improvements in the event that profits are high. Yet, in the same breath, the ILECs want prescriptive revenue guarantees that would keep them whole even in the event that profits are low. No matter that they can’t identify with particularity what costs are associated with up to half of the TIC. 7/ Under the ILECs’ skewed theory, any revenues that they receive now should keep flowing . . . because they are “the phone company.”

WorldCom has suggested a measured approach that would recognize the state of the local marketplace for what it is -- only nascently competitive -- and

6/ See, e.g., BellSouth Comments at 25; Bell Atlantic/NYNEX Comments at 58-60.

7/ See, e.g., Southwestern Bell Comments at 9-10; see also USTA Comments, Attachment 10 at 11, and Attachment 11. And, as we discuss below, the ILECs’ claims regarding the portion of the TIC that they do purport to quantify -- of which a large part would be reassigned to tandem-switched transport -- are extraordinarily weak. See *infra* Section III.C.

would set the stage for growing competition. Under this approach, access rates would be restructured to shift revenues so as to maximize competitive pressure on the ILECs. At the same time, the Commission would outline the steps by which the ILECs gradually would be granted increasing pricing flexibility as the local markets are truly opened to competition. We support a market-based approach, and we fully recognize that the ILECs ultimately should be deregulated -- but timing is everything. The Commission must not be taken in by the ILECs' arguments for premature deregulation, which would squelch local competition before it even gets off the ground, or for revenue guarantees, which would make it impossible for entrants to compete against such revenues and would force them to subsidize their biggest competitors.

B. The Commission Should Not Heed the ILECs' Scare Tactics and Red Herrings

The ILECs claim, both in their filings in this proceeding and in advertisements in the general press, that high access charges are needed to assure universal service support and to protect their incentives to continue investing in and maintaining their world-class local networks. Both of these arguments are red herrings, and should be paid little heed. Universal service support -- specifically, support needed for consumers in high-cost areas and low-income consumers -- is being addressed in a different proceeding, and will be supported through a truly competitively neutral mechanism, into which all carriers will pay, and from which

all carriers providing local services will be eligible to draw. 8/ By contrast, none of the mechanisms suggested by the ILECs in this proceeding, such as bulk billing, would be “competitively neutral.” 9/ All would single out access customers (i.e., IXCs), and possibly also purchasers of unbundled network elements, to pay burdensome and distortive subsidies to their prospective competitors, the ILECs. Such subsidies would violate the express statutory requirement of Section 254 that universal support be “equitable and non-discriminatory.” 10/ The 1996 Act thus forbids the use of access charge revenues to support universal service.

Similarly, the argument that high access charges and revenue guarantees are necessary to assure continued network investment is baseless. In fact, the Commission has found in the past that the rate-of-return regulatory system, which -- like the guarantees the ILECs now seek -- ensured that every dollar invested would be matched by revenue dollars, created inefficient incentives

8/ 47 U.S.C. § 254; Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Recommended Decision, FCC 96J-3 (released Nov. 8, 1996).

9/ See, e.g., GTE Comments at 41-44 (proposing “bulk billing” a “regulatory policy charge” to all carriers that purchase ILEC interstate access and unbundled elements); BellSouth Comments at ii (proposing recovery of depreciation reserve deficiency by “bulk billing” IXCs based on share of revenues over past three years -- which effectively would exclude future RBOC interLATA affiliates); US West Comments at 72-73 (proposing recovery of TIC from IXCs based on shares of switched access minutes).

10/ 47 U.S.C. § 254(b)(4) & 254(d).

for investment. 11/ A much more powerful guarantor of local network investment and ongoing quality improvements would be to promote competition for local telecommunications services. If competition forces the ILECs to scramble for customers and revenue, they will need to invest in their networks to remain competitive. Yet the revenue guarantees that the ILECs seek would stifle the development of local competition. 12/

Finally, the ILECs argue that the Commission is legally prohibited from imposing local competition-related preconditions for increased pricing flexibility in this proceeding. This is absolutely false. Even if the Eighth Circuit ultimately concludes that the Commission overstepped its authority in adopting pricing rules pursuant to Sections 251 and 252 (which it has not done to date; it has only issued a stay pending the outcome of the litigation), this has no effect on the Commission's well-established authority under Sections 201-205 to adopt rules regarding the pricing of interstate access services. The conditions that the Commission proposed for Phase I pricing flexibility are well within the established parameters of regulation under Sections 201-205. 13/ At minimum, premature

11/ Indeed, the larger ILECs have embraced the notion of "pure" price cap regulation, which would provide no guaranteed return on ILEC investment.

12/ See WorldCom Comments at 22-24, 59-72. Such revenue guarantees would deter WorldCom and other competitors from constructing competing local network facilities. Meanwhile, the ILECs will have their network element costs fully reimbursed through the interconnection process.

13/ Cf. Expanded Interconnection with Local Telephone Company Facilities, 7 FCC Rcd 7369, 7454-7455 ¶¶ 179-80 (1992), recon., 8 FCC Rcd 127 (1992), second

relaxation of ILEC price regulation would violate the public interest, and thus would itself be inconsistent with these provisions of the Act.

Indeed, while the Commission may not deprive a party of its Constitutional rights, it may withhold a privilege -- pricing flexibility, to which the ILECs have no legal entitlement -- unless the party voluntarily satisfies a related condition that is proportional to that privilege, even if the Commission lacks authority to require the party to satisfy the condition. ^{14/} The ILECs apparently rely on the doctrine of "unconstitutional conditions," under which "the government may not require a person to give up a constitutional right . . . in exchange for a discretionary benefit conferred by the government where the property sought has little or no relationship to the benefit." ^{15/} But the Supreme Court has clearly held that a condition is constitutional where, as here, (1) there exists an "essential nexus" between the "legitimate state interest" and the condition, and (2) there is a "rough proportionality" between the condition and the discretionary benefit. ^{16/}

[Footnote continued]

recon., 8 FCC Rcd 7341 (1993), reversed on other grounds and remanded sub nom. Bell Atlantic Tel. Cos. v. FCC, 24 F.3d 1441 (1994).

^{14/} This is no different from saying, for example, that (outside the context of taxation) the government cannot force me to pay it \$10, but it can withhold the privilege of visiting a national park unless I voluntarily pay \$10.

^{15/} Dolan v. Tigard, 114 S.Ct. 2309, 2317 (1994). See USTA Comments, Attachment 3, Affidavit of J. G. Sidak & D. F. Spulber at 99-101.

^{16/} Nollan v. California Coastal Comm'n, 483 U.S. 825, 834, 837 (1987); Dolan, 114 S.Ct. at 2317, 2319.

This constitutional standard clearly would be satisfied here, where the ILEC's satisfying the prerequisites to vibrant local competition is directly related to and proportional to the pricing flexibility that would be granted to the ILEC in an increasingly competitive local marketplace.

C. A "Reasonable Opportunity" for Recovery Does Not Equate to An Absolute Guarantee; and the ILECs Depreciation Claims Are Bogus.

The Commission is required only to give the ILECs (and all other common carriers) a "reasonable opportunity" to obtain a reasonable return on their investments. 17/ But the Commission should ignore the ILECs' pleas to transmute that "reasonable opportunity" into a prescriptive guarantee. If, once local competition develops, the ILECs lose some of their customers and cannot raise rates on the remaining customers without losing more revenue -- that is the way competition is supposed to work under the 1996 Act. Competition guarantees nothing but the maximum opportunities for consumers and competitors alike.

The ILECs' arguments regarding depreciation ignore this basic point. They also seem to forget the intensity of their own successful campaign to replace rate-of-return guarantees with price caps. There is no evidence in the record now that would compel the Commission to reverse the reasonable decision it made in 1990, when adopting price cap regulation, not to guarantee price cap LECs recovery

17/ FPC v. Hope Natural Gas Co., 320 U.S. 591 (1934); Duquesne Light Co. v. Barasch, 488 U.S. 299 (1989).

of their depreciation expenses and to treat depreciation as an endogenous cost under price caps (i.e., a cost that should not affect rate changes in the price cap system). ^{18/} The Commission found that a guarantee of depreciation recovery would run counter to the productivity and efficiency incentives of the price cap system:

[W]hile we determine the rate of depreciation, we do not decide for carriers when to deploy new plant and when to retire the old. We believe that such decisions are at the very heart of a carrier's business operation, and we do not seek to disturb it. Accordingly, it is not this Commission, but the carrier, through its decisions on when to deploy and retire equipment, that primarily controls the rate at which plant investment is translated into depreciation expense. . . . [I]f we were to guarantee recovery of depreciation expense for carriers, we would risk destroying the very incentives that we wish to create with the price cap program. ^{19/}

Seven years later, the ILECs' argument for guaranteed recovery of depreciation expense is far weaker now than it was then.

The main thrust of the ILECs' arguments seems to be that Commission policies in the past imposed unreasonably slow depreciation schedules, which made it impossible for them to recover their investments in a timely manner. Even if one were to concede this basic point (and we do not), it must be qualified in

^{18/} Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, Second Report and Order, 5 FCC Rcd 6786, 6809, ¶¶ 182-187 (1990), aff'd in pertinent part on recon., 6 FCC Rcd 2637, 2672, ¶¶ 74-75 (1991), aff'd sub nom. National Rural Telecom Ass'n v. FCC, 988 F.2d 174 (D.C. Cir. 1993).

^{19/} Id., 5 FCC Rcd at 6809, ¶¶ 182-83.

a number of ways. 20/ First, at the ILECs' behest, the depreciation schedules for much of their equipment were accelerated substantially over the past decade and a half, and the ILECs were permitted to amortize and recover depreciation reserve deficiencies. As a result, the alleged problem, which at most applies only to dollars in the rate base before the inception of price cap regulation, was largely eliminated by the time price cap regulation was initiated. Moreover, the depreciation process has been substantially streamlined, giving the ILECs a far greater degree of control over their own depreciation rates. And of course, as discussed above, since the inception of price cap regulation, depreciation changes have had no effect on ILEC rates. The price cap ILECs have absolutely no claim to revenue guarantees relating to depreciation expenses since 1991.

In addition, a significant part of the ILECs' depreciation argument seems to be grounded in a contention that technological changes reduced the economic value of the ILECs' investment (after the plant was purchased and depreciation schedules were established), and that the Commission should enable the ILECs to recover additional revenue to compensate them for this reduction in economic value. But even thoroughly regulated utilities in a monopoly environment

20/ We are aware of no quantification on the record of this proceeding of the amount of undepreciated amounts that were incurred before 1991 (when price caps began) and that are claimed to be attributable to incorrect FCC depreciation prescriptions based on what was known then about the rate at which equipment became unusable or obsolescent. We speculate, however, that any such amount is likely to be minuscule.

have to live with the risk that the value of their investments may decline. And the 1996 Act stipulates that the ILECs no longer exist in a monopoly environment, in which the value of their investments are guaranteed, but instead must take their chances with everybody else in the competitive market.

D. The ILECs Must Fully Implement the Prerequisites for Local Competition In Order to Earn Greater Pricing Flexibility.

WorldCom is optimistic that local competition can emerge in the relatively near future -- but this will happen only if the Commission sets the stage properly. The Commission can use access reform to accelerate the process of local competition -- or, if it follows the ILECs' advice, it can snuff out any possibility of local competition by providing the ILECs with an unwholesome mix of revenue neutrality and premature deregulation. It is vitally important for the Commission to insist that the ILECs receive their pro-competitively structured pricing flexibility only after the Phase I thresholds are met. This includes, in particular, reasonable pricing of unbundled network elements and other interconnection offerings, and working operational support systems ("OSS") to facilitate the development of local competition. As with AT&T in the long distance market, the Commission should grant the ILECs streamlined regulation, and ultimately deregulation, only when a vibrantly competitive local telecommunications marketplace develops.